UNITED STATES TAX COURT
WASHINGTON, DC 20217

PA

PBBM-ROSE HILL, LTD., PBBM CORPORATION, TAX MATTERS PARTNER,	)	
Petitioner	)	
v.	)	Docket No. 26096-14.
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

ORDER OF SERVICE OF TRANSCRIPT

Pursuant to Rule 152(b), Tax Court Rules of Practice and Procedure, it is

ORDERED that the Clerk of the Court shall transmit herewith to petitioner and to respondent a copy of the pages of the transcript of the trial of the above case before Judge Richard T. Morrison, at Washington, D.C., on September 9, 2016, containing his oral findings of fact and opinion rendered at the conclusion of the trial.

In accordance with the oral findings of fact and opinion, an appropriate order and decision will be entered under Rule 155.

(Signed) Richard T. Morrison
Judge

Dated: Washington, D.C.
October 7, 2016

SERVED Oct 11 2016

Bench Opinion by Judge Richard T. Morrison

September 9, 2016

PBBM-Rose Hill, Ltd., PBBM Corporation, Tax Matters Partner v. Commissioner

Docket No. 26096-14

THE COURT: The Court has decided to render oral findings of fact and opinion in this case (a bench opinion), and the following represents the Court's oral findings of fact and opinion. References to sections are to sections of the Internal Revenue Code of 1986, as amended. References to Rules are to the Tax Court Rules of Practice and Procedure. This bench opinion is made under the authority of section 7459(b) and Rule 152.

Findings of Fact

The petitioner is PBBM Corporation. RTM

Petitioner is the Tax Matters partner of PBBM-Rose Hill, Ltd., a partnership referred to here as PBBM. When the petition was filed, PBBM's principal place of business was in Texas. Therefore, an appeal of this case would go to the U.S. Court of Appeals for the Fifth Circuit unless the parties designate a different circuit in writing. See sec. 7482(b)(1)(E), (b)(2).

In 2002, PBBM bought a 241-acre golf course, consisting of 27 holes, from Rose Hill Country Club, Inc., for $2,442,148. The 241 acres is located in Beaufort County, South Carolina. The golf course was largely interspersed among the houses of a gated community.

In January 2006, PBBM ceased all business operations on the golf course.

On March 2, 2006, Carolina First Bank filed a foreclosure action with respect to the golf-course property.

On March 21, 2006, PBBM, whose only major asset was the golf-course property, filed a voluntary chapter 11 bankruptcy petition.

On December 28, 2007, PBBM contributed a conservation easement to the North American Land Trust, or NALT, with respect to the golf-course property except for 2 acres of golf course maintenance areas and 5 acres of clubhouse acreage. Thus, the burdened acreage was 234 acres. The easement generally prohibited development of the property.

On December 31, 2007, PBBM sold the golf course to a subsidiary of the Rose Hill Plantation Property Owners Association, a homeowners association

referred to here as the POA, for $2,300,000. Petitioner and Respondent agree that the sale was not completed for income-recognition purposes until January 2008.

In 2008, PBBM timely filed its 2007 partnership tax return on Form 1065. PBBM claimed a charitable contribution deduction for the easement of $15,160,000. The deduction was premised on the value of the easement being $15,160,000.

In 2014 the IRS issued a notice of final partnership administrative adjustment for PBBM for 2007. In this notice, referred to here as the FPAA, the IRS determined that PBBM was not entitled to a deduction for the contribution of the easement to NALT. It also determined that all underpayments attributable to the claimed $15,160,000 deduction are subject to the 40 percent penalty of section 6662(h) or alternatively the 20 percent penalty of section 6662(a).

Petitioner filed a petition challenging the determinations in the FPAA. At trial Petitioner takes the position that the value of the easement was $13,380,000. Respondent takes the position that the value of the easement was $100,000. We hold that the value was $100,000. We also hold that no deduction

for the contribution of the easement is allowed by the Code for two reasons other than valuation: the extinguishment requirement and the protected-in-perpetuity requirement. We also hold that the underpayments corresponding to the difference between a $15,160,000 deduction and a $100,000 deduction are subject to the 40 percent penalty and that the underpayments corresponding to the difference between a $100,000 deduction and a $0 deduction are not subject to any penalty under section 6662.

Opinion

As a preliminary matter, we consider Petitioner's contention that the burden of proof with respect to the deductibility of the charitable contribution has shifted to Respondent pursuant to section 7491(a). We need not resolve whether it is Petitioner or respondent who bears the burden of proof because our findings with respect to the deduction are supported by the preponderance of the evidence. The burden of proof as to the penalty is discussed later in the context of the penalty.

1. Does the easement fail to satisfy the perpetuity requirements of sections 170(h)(2)(C) and 170(h)(5)(A) because it was a voidable gift made

without bankruptcy court approval while PBBM was in bankruptcy proceedings?

Respondent argues that the grant of the easement is not a qualified conservation contribution because the bankruptcy trustee could have voided the grant of the easement as of December 31, 2007, the close of PBBM's 2007 tax year.

On March 21, 2006, PBBM filed for chapter 11 bankruptcy.

On October 1, 2007, the bankruptcy court confirmed the plan of reorganization.

On December 28, 2007, PBBM granted the conservation easement.

Section 549 of the Bankruptcy Code allows a bankruptcy trustee to avoid unauthorized post-petition transfers of the property of the bankruptcy estate. It is unclear whether the transfer of the easement could have been avoided. First, the contribution of the easement was arguably not made out of the property of the estate because it was made by the reorganized debtor. Second, even if the contribution was made out of the property of the estate, it was arguably authorized by the plan of reorganization. We need not reach the question of whether the possibility of avoidance causes the

easement to fail to satisfy section 170 because we hold that it fails for the two other reasons.

2. Does the easement fail to satisfy the perpetuity requirements of sections 170(h)(2)(C) and 170(h)(5)(A) because certain rights reserved by the easement to the landowner allow for inconsistent uses?

Section 170(h)(1) defines a qualified conservation contribution as a contribution of a qualified real property interest exclusively for conservation purposes. Under section 170(h)(2)(C), a qualified real property interest includes an interest in real property that is a perpetual restriction on the use of the real property. Section 170(h)(5)(A) provides that a contribution is not treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

Respondent argues that the restrictions of the easement are not perpetual because the easement reserves rights to the owner of the underlying property, including the rights to alter the golf course, build 12 clay tennis courts, build a tennis pro shop, build two houses, create a driveway, create 6,000 square feet of parking areas, and build six-foot high fences. The easement permits the majority

of the acreage to be used as a golf course. These reserved rights do not impair the conservation purpose any more than the use of the property as a golf course, which is also permitted by the easement. Therefore, these reserved rights alone do not cause the easement to fall outside the definition of a qualified conservation contribution.

3. Does the easement fail to satisfy the perpetuity requirement of section 170(h)(5)(A) because it does not comply with the extinguishment requirement of Treas. Reg. sec. 1.170A-14(g)(6)?

Treas. Reg. sec. 1.170A-14(g) elaborates on the protected-in-perpetuity requirement of section 170(h)(5)(A) by setting forth substantive rules to safeguard the conservation purpose of a contribution. Subdivision - 14(g)(6)(ii) of this regulation requires that at the time of the gift the donor must give the donee the right, in the event the conservation restriction is extinguished by a judicial proceeding, to a portion of the proceeds received for the whole property that is at least equal to the proceeds received for the whole property, RTM and multiplied by the value of the restriction at the RTM time of the gift, and divided by the value of the property as a whole at the time of the gift.

The easement provides that in the event the easement is extinguished by a judicial proceeding, NALT would be entitled to an amount determined by a formula. The formula is written such that under some circumstances NALT would not receive the minimum amount required by the regulation. We hold that the easement does not meet the requirement of the regulation. As a result, PBBM is not entitled to a charitable contribution deduction for the contribution of the easement to NALT. See Treas. Reg. sec. 1.170A-14(g)(4)(ii).

4. Does the easement fail to protect any conservation purpose within the meaning of section 170(h)(4)(A)?

One conservation purpose under section 170(h) is the preservation of land areas for outdoor recreation of the general public. Sec. 170(h)(4)(A)(iii). Examples of outdoor recreation include boating, fishing, and the use of hiking trails by the public. Treas. Reg. sec. 1.170A-14(d)(2)(i). The question is whether this conservation purpose is protected by the 2007 easement in perpetuity. Sec. 170(h)(5)(A). The golf course was closed in January 2006. PBBM granted the conservation easement in December 2007 and sold the

golf course shortly thereafter. The easement requires that the underlying property be open for substantial and regular use by the general public for outdoor recreation, whether for golf or otherwise. According to the easement, this requirement can be enforced by NALT in court. However, the easement also provides that it does not create any right of access by the public to the easement area.

After the sale, the new owner, a subsidiary of the POA, converted 9 holes of the golf course into a driving range and a park. It operates the remaining 18 holes as a golf course. The entire area covered by the easement is accessible by car only by a single road. The road is controlled by a gatehouse owned and operated by the POA. A car is allowed past the gatehouse only after the guard at the gatehouse ascertains that the occupants of the car are in the area to play golf, play tennis at tennis courts constructed by the new owner, or eat at the clubhouse. The guard gives the driver of the car a restricted pass that reflects the purpose of the visit. The restricted pass contains a warning that any use of the pass for another purpose is not authorized and constitutes trespassing. The restricted pass must be displayed on the vehicle. A

car must get past the gatehouse to get to the road to the park. A sign on the road to the park reads "Property owners, residents & guests only beyond this point." Thus, a significant portion of the property governed by the easement, the park, is relatively inaccessible to the public. The creation of a private park out of a substantial part of the property subject to the easement demonstrates to us that the easement fails to protect the use of the land for outdoor recreation of the general public.

Another conservation purpose under section 170(h) is the preservation of open space, including farmland and forest land, where such preservation is (1) for the scenic enjoyment of the general public or (2) pursuant to a clearly delineated federal, state, or local government conservation policy. Sec. 170(h)(4)(A)(iii). The preservation must yield a significant public benefit. Id. Regulations provide that all pertinent facts and circumstances germane to the contribution, including eight particular factors, are considered in determining whether the preservation is for the scenic enjoyment of the general public. Treas. Reg. sec. 1.170A-14(d)(4)(ii)(A).

We find that the easement does not preserve the land for the scenic enjoyment of the general public. Only a small part of the property is visible from off the property. See Treas. Reg. sec. 1.170A-14(d)(4)(ii)(B). The non-golfing general public is not allowed vehicular access to the golf course. The general public is not allowed to drive to the park. We find that the easement preserves open space mainly for the benefit of the owners of the houses abutting the golf course. The benefit to the public is not significant.

We also find that the easement does not preserve open space pursuant to a clearly delineated federal, state, or local government conservation policy. There are several government programs that evince a policy to protect ecology, including the Beaufort County Rural and Critical Land Preservation Program, the Federal Coastal and Estuarine Land Conservation Program, and the South Carolina Coastal and Estuarine Land Conservation Plan. Whether the 2007 easement pursues any of these policies involves the question of how much ecological value the easement has. As explained shortly, we agree with respondent's expert ecologist witness that the RTM ecological value is low. We also consider the

explanation by petitioner's expert ecologist witness that the walking trails on the restricted property are compatible with the Southern Beaufort Greenway Plan, which contains projects for developing walking trails along the highway bordering the property on the north side of the property. However, the easement has not prevented the POA from blocking automobile access to the park. We see no guarantee that the POA could not also impede pedestrian access to portions of the property subject to the easement.

We find that the easement fails to preserve open space as defined by section 170(h)(4)(A)(iii).

Another conservation purpose is the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem. Sec. 170(h)(4)(A)(ii). Each party called an ecologist as an expert witness. The experts disagreed as to the value of the easement in protecting this conservation purpose. Respondent's expert ecologist witness testified credibly and with corroboration from the record. In particular he made the following points: most of the bird species on the property are common backyard species; the wood stork, a threatened species, forages on the property but the data showed that the wood stork does not visit the easement area

frequently compared to other areas of the county; most of the easement area is golf-course area; the diversity of species on the golf course and park is limited; the golf course is dominated by non-native grass species; the golf course requires continued application of fungicides and pesticides, resulting in pollution; the golf course is not conducive to wildlife; although alligators live on the protected property, this is a relatively unimportant species ecologically; the quality of the ponds in the easement area is similar to that of waterways in urban areas; and many of the trees in the easement areas are in isolated patches or thin strips.

In addition to these observations made by Respondent's expert ecologist witness, the record shows that although much of the golf course is covered by tree canopy, many of the trunks of the trees providing the canopy are outside the easement area. Therefore, these trees are not protected by the easement.

On this record, we find that the easement area is not a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem. And we find that the easement does not protect in perpetuity a relatively natural habitat of fish, wildlife, or

plants, or a similar ecosystem. See sec. 170(h)(4)(A)(iii); (5)(A). We specifically reject the proposition that the easement area is a habitat for wood storks. Although wood storks forage on the property, this foraging activity does not convince us that the property is a habitat for the wood stork. This finding is relevant to Treas. Reg. sec. 1.170A-14A(d)(3)(ii), which states "Significant habitats and ecosystem include, but are not limited to, habitats, for rare, endangered, or threatened species of animal, fish or plants."

In conclusion we hold that the easement does not protect any conservation purpose in perpetuity. No deduction is therefore allowable to PBBM under section 170 for the contribution of the easement to NALT. See sec. 170(f)(3), (h)(1).

5. Did PBBM fail to attach a completed summary appraisal, Form 8283, to its 2007 Form 1065?

Section 170(a)(1) allows as a deduction any charitable contribution verified under regulations prescribed by the Treasury Secretary. Section 170(f)(11)(A) provides that no deduction is allowed in the case of an individual, partnership, or corporation, under section 170(a), for any contribution of property for which a deduction of

more than $500 is claimed unless such person meets the requirements of section 170(f)(11)(B), (C), or (D) as the case may be, unless the failure to meet such requirements is due to reasonable cause and not willful neglect. Section 170(f)(11)(C) provides that in the case of a contribution of property for which a deduction of more than $5,000 is claimed, the person must obtain a qualified appraisal of the property and attach to the return for the taxable year in which such contribution is made such information regarding such property and regarding the appraisal of the property as the Secretary may require. A regulation, Treas. Reg. sec. 1.170A-13(c)(1), provides that no deductions are available with respect to a charitable contribution of property by a partnership, and other types of persons, unless the three substantiation requirements in subparagraph -13(c)(2) are met. The second substantiation requirement of subparagraph -13(c)(2) is that the donor must attach a fully completed appraisal summary to its tax return. Treas. Reg. sec. 1.170A-13(c)(2)(i)(B). The appraisal summary must include, among other things, a brief summary of the overall physical condition of the property (in the case of tangible property), the manner and date of acquisition, and the cost or other

basis of the property. Treas. Reg. sec. 1.170A-13(c)(4)(ii). The IRS has designated Form 8283 to be used for this appraisal summary. The Form 8283 contains blanks for the information referred to above, as well as a blank for the amount claimed as a deduction.

PBBM attached to its 2007 partnership return a Form 8283 signed by Raymond Veal as appraiser. It also attached Veal's appraisal.

Respondent contends that the Form 8283 omitted the following items: a summary of the physical condition of the property, the date the property was acquired, how the property was acquired, the donor's cost, and the amount claimed as a deduction. These items of information are indeed missing from the Form 8283 attached to the return. Form 8283, Section B, Part I contains blanks for the taxpayer to enter the information. PBBM did not fill in these blanks. However, we agree with ~~the~~ RTM Petitioner that it is unclear whether a taxpayer donating an intangible right should fill out Section B, Part I, and if so, how these blanks should be filled out for such a contribution. Furthermore, we find that the missing information could be found on other parts of the Form 1065 and attachments.

Therefore, we hold that PBBM substantially complied with the requirement that a completed appraisal summary be attached to the return.

6. Did PBBM fail to obtain a qualified appraisal as required by section 170(f)(11)(C)?

A qualified appraisal is any appraisal considered to be a qualified appraisal for the purpose of section 170(f)(11) under regulations or other guidance prescribed by the Secretary. Sec. 170(f)(11)(E)(i)(I). A regulation, Treas. Reg. sec. 1.170A-13(c)(3)(ii), contains a list of information that must be in a qualified appraisal. Respondent contends that Veal's appraisal attached to the Form 1065 fails to conform to this regulation because his appraisal "fails to provide a description of the easement itself or the date or expected date of contribution", "fails to properly describe the real estate", "fails to address the easements and restrictions already associated with the property prior to the conservation easement", "fails to address the terms of the agreement relating to the use, sale or disposition of the property", "fails to include a statement that it was prepared for income tax purposes", and "fails to use the proper measure of value" because the appraisal refers to market

value and not the fair market value definition as set forth in Treas. Reg. § 1.170A-1(c)(2)." We disagree. We find that the Veal appraisal contains all the information required in the regulation.

7. What is the value of the easement?

Petitioner called Veal as an expert witness. In a deviation from his appraisal that was attached to PBBM's return, he testified that the value of the easement was $13,380,000. Mathematically this is the difference between $15,680,000, which he testified was the pre-easement value of the 241-acre property, minus $2,300,000, which he testified was the post-easement value of the property. Veal assumed that before the easement it was legally permissible to use significant portions of the property for commercial and residential uses. He concluded that the highest and best use of the property was to convert portions of the property to commercial use, multifamily use, and single-family use.

Respondent's expert witness, Terry Dunkin, concluded that the value of the easement was $100,000. He determined that the value of the 241 acres before the easement was $2,400,000. In arriving at his conclusion about the pre-easement

value, he assumed that zoning restrictions allowed the property to be used only for open space or recreational use, that it was highly unlikely it could be rezoned for development, and that the owners of the adjoining houses would likely oppose development. He therefore concluded that the highest and best use of the property was a golf course.

The two expert valuation witnesses thus disagreed about whether the property could have been developed. On this important question, there was conflicting evidence on whether the owner of the property would have been permitted to develop the property and whether the adjoining homeowners ~~could~~ would oppose development of the property. Weighing the conflicting evidence, we find: first, it was uncertain that the owner of the property could have developed the property without permission of the county; second, it was uncertain that the county would have given its permission had such permission been required; third, the adjoining homeowners were opposed to development of the property; fourth, this opposition would have reduced the chance that the county would have permitted development had its permission been required; and fifth, this opposition would have also put economic pressure on the property

RTM

owner to leave the property undeveloped. Moreover, we find these uncertainties about the possibility of developing the property were so great that an owner would have been discouraged from pursuing development of the property.

Our finding is supported by the fact that PBBM, which owned the property until January 2008, chose not to develop the property or sell the property to a property developer. Instead, PBBM sold the property to a subsidiary of the POA. We believe that if PBBM had thought the property was worth $15,680,000 because of its development potential, it would not have sold the property to the subsidiary of the POA for only $2,300,000. Although petitioner suggests that PBBM was motivated by environmental concerns to give up $15,680,000 of value, we believe PBBM made a business decision that development was not feasible. PBBM bought and operated the golf course to make money. Its business decisions were ultimately made by Pat Bolin. Bolin was the majority partner of PBBM and the owner of PBBM Corporation, which was PBBM's general partner. Although there was vague testimony that Bolin was interested in conservation, Petitioner did not call Bolin as a

witness to explain why he contributed the easement to NALT.

We conclude the easement was contributed to NALT because he did not think that developing the property or selling the property to a developer was feasible. This is consistent with the explanation that PBBM supplied to the bankruptcy court when it asked the bankruptcy court permission to sell the property to a subsidiary of the POA for only $2,300,000. PBBM assured the bankruptcy court that selling the property at such a price was in the best interests of the bankruptcy estate and the creditors.

We find that an objective value of the property before the easement would not include the development potential of the land. We agree with Dunkin that the pre-easement value of the property was only $2,400,000. We find that the easement was worth only $100,000.

8. Should the section 6662 penalty be imposed?

Section 6662(a) imposes a penalty equal to 20 percent of an underpayment due to specified causes. These causes include negligence or disregard of rules or regulations, substantial understatement of income tax, and substantial valuation misstatement. Sec. 6662(b)(1), (2), (4). To the

extent that any portion of an underpayment is attributable to a gross valuation misstatement, the penalty is increased to 40 percent under section 6662(h).

A gross valuation misstatement exists if the value of property claimed on the tax return is 200 percent or more of the amount determined to be the correct amount of such valuation. Sec. 6662(e)(1), (e)(1)(A), (h)(1), (h)(2). The value of the easement reported on PBBM's return, $15,160,000, was 15,160 percent of the amount we determine to be its value, $100,000. Therefore, there was a gross valuation misstatement. The law allows no reasonable cause/good faith exception to the penalty on gross valuation misstatements. Sec. 6664(c)(2).

Petitioner contends that respondent's RTM assertion of the 40 percent penalty for a gross valuation misstatement does not comply with section 6751(b). Section 6751(b) provides that no penalty shall be assessed unless the initial determination of such assessment is personally approved in writing by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.

We recite the facts regarding respondent's assertion of the 40 percent penalty.

In 2008, PBBM filed its Form 1065, claiming a charitable contribution deduction of $15,160,000. On November 16, 2011, Gaylon Berg, an IRS manager, sent to PBBM Corporation a so-called 30-day letter regarding PBBM. Berg attached to the 30-day letter "Our summary report on the examination of PBBM" and stated that the report "explains all proposed adjustments including facts, law and conclusion." The examination report attached to the 30-day letter included a document entitled "Gross Valuation Overstatement Penalty Issue Lead Sheet" stating that examiner Jerry Walker had determined that the 40 percent penalty applies to underpayments attributable to the $15,160,000 claimed deduction for the conservation easement. This lead sheet was dated November 14, 2011, two days before the date of the 30-day letter. Walker's manager was Berg.

On May 8, 2014, the IRS Appeals Office prepared a document entitled "Appeals Transmittal and Case Memo". The document was signed by Appeals Officer Robert Wolff and Appeals Team Manager Carla Washington. The document stated "Assessment is fully supported by Compliance's development." It further

stated "Please use the standard language for 40 percent penalty under IRC 6662(h) and the alternative position of the 20 percent penalty under IRC 6662."

On August 11, 2014, the IRS issued the FPAA determining that PBBM's $15,160,000 deduction for the easement was attributable to a gross valuation misstatement under section 6662(h) and that the 40 percent penalty should be imposed on the underpayments resulting from the claiming of the entire deduction.

Respondent argues that an assessment of the 40 percent penalty has not yet occurred and therefore it is premature to consider whether section 6751(b) has been satisfied. This argument rests upon the observation that assessment of the 40 percent penalty is suspended by the Internal Revenue Code until this partnership proceeding is over. Respondent has also made this argument in another pending case. We need not determine whether the argument has merit. Even assuming that an initial determination of an assessment of a 40 percent penalty can occur during a period in which assessment is barred (and thus rejecting respondent's argument), the initial RTM determination to assert the 40 percent penalty as to PBBM's deduction would have been made by Walker in

the examination report dated November 14, 2011. See Legg v. Commissioner, 145 T.C. No. 13, slip op. at 11 (2015).

The November 16, 2011 cover letter by Berg is the personal written approval of Walker's determination to impose the 40 percent penalty. Berg was Walker's supervisor. Therefore, we find that Walker's determination was personally approved by his immediate supervisor in writing. Alternatively even if the initial determination were considered not have been made by Walker, the examiner, but by Wolff, the appeals officer, the determination by Wolff that the penalty was appropriate was approved in writing by Wolff's superior, Washington. We therefore conclude that the IRS's assertion of the 40 percent penalty did not violate section 6751(b).

We now consider the significance of our holding that there was a gross valuation misstatement on PBBM's return for 2007 because PBBM valued the easement at $15,160,000 rather than $100,000. PBBM's reporting of a charitable contribution deduction of $15,160,000 means that there were underpayments of taxes by PBBM's partners. The amounts of these underpayments are of two types. First, there are the amounts of underpayments resulting from PBBM's

reporting of a $15,160,000 deduction instead of a $100,000 deduction. Second, there are additional amounts of underpayments that correspond to the difference between a $100,000 deduction and a $0 deduction. The amounts corresponding to the first type of underpayment are attributable to a gross valuation misstatement. These amounts are subject to the 40 percent penalty. The amounts corresponding to the second type of underpayment, the IRS concedes, are not subject to the 40 percent penalty. Respondent contends that the amounts corresponding to the second type of underpayment are subject to the 20 percent penalty.

Respondent determined that the 20% penalty was appropriate because of negligence or disregard of rules or regulations, or alternatively, because of a substantial understatement of income tax. See sec. 6662(b)(1) and (2), (c), (d). Respondent bears the burden of production on the applicability of this 20 percent penalty in that he must come forward with sufficient evidence indicating that it is proper to impose it. See sec. 7491(c); see also Higbee v. Commissioner, 116 T.C. 438, 446 (2001). Once Respondent meets this burden, the burden of proof remains with Petitioner, including the burden of

proving that the penalty is inappropriate because of reasonable cause and good faith. See Higbee v. Commissioner, supra at 446-447. Even if Respondent has met his burden of production, we hold that the 20 percent penalty is inappropriate because of reasonable cause and good faith.

Pursuant to section 6664(c)(1), the 20 percent penalty under section 6662 does not apply to any portion of an underpayment for which a taxpayer establishes that the taxpayer (1) had reasonable cause and (2) acted in good faith. Whether a taxpayer acted with reasonable cause and in good faith depends on the pertinent facts and circumstances, including the taxpayer's efforts to assess the proper tax liability, and including the taxpayer's knowledge and experience. Treas. Reg. sec. 1.6664-4(b)(1). We agree with Petitioner that Brad Ayres, on behalf of PBBM, made a reasonable attempt to comply with the Internal Revenue Code and that he acted in good faith.

Although Respondent contends that the deduction for the easement is unavailable because the bankruptcy trustee could have avoided the easement during the last few days of 2007, it is questionable that the transfer could have been avoided. See part

1. We find that the possibility of avoidance does not demonstrate that PBBM operated in bad faith.

As discussed in part 3, we hold that the amount that NALT would receive in the event of the judicial extinguishment of the easement would be insufficient to meet the regulatory requirement in some circumstances. However, it appears that the amount would meet the regulatory requirement in many circumstances. We conclude that the formula in the easement was an imperfect, but good faith, attempt to satisfy the regulation.

As discussed in part 4, we hold that the easement failed to protect conservation purposes in perpetuity. Although the easement is ineffectual at protecting conservation purposes, it appears to have been good faith attempt to meet the requirements of the Internal Revenue Code.

In summary we hold that the 40 percent penalty of section 6664(h) is applicable to the underpayments corresponding to the difference between a deduction of $15,160,000 and a deduction of $100,000. We hold that no penalty is applicable to the underpayments corresponding to the difference between a deduction of $100,000 and a deduction of $0.

A decision will be entered under Rule 155.

This concludes the bench opinion and this trial session is adjourned.

THE CLERK: All rise.

(Whereupon, at 3:42 p.m. the above-entitled matter was concluded.)